



JUN | 3 1995

Memorandum

Date

for *Michael Mangano*
June Gibbs Brown
Inspector General

Subject

Review of Home Office Costs of Surgical Care Affiliates, Inc.
(A-04-94-02091)

To

Bruce C. Vladeck
Administrator
Health Care Financing Administration

Attached are two copies of our final report entitled, "Review of Home Office Costs of Surgical Care Affiliates, Inc." The Health Care Financing Administration (HCFA) requested that the Office of Inspector General audit the home office costs allocated by two major ambulatory surgical center (ASC) chains to the individual ASCs owned by these chains and included in a sample of 100 ASCs responding to a HCFA survey.

The HCFA survey focused on overhead and certain surgical procedure costs and other items related to services rendered at ASCs participating in the Medicare program. The HCFA asked the Medicare fiscal intermediaries (FI) to audit the survey responses provided by the individual ASCs. The purpose of our review was to validate the reported home office costs that would be used by HCFA in developing new ASC facility payment rates and to determine if these costs were reimbursable under Medicare regulations and guidelines. Of the 100 ASCs included in HCFA's sample, 5 were part of the Surgical Care Affiliates, Inc. (SCA) chain.

Generally, Medicare regulations and guidelines require that reimbursable costs be reasonable, related to patient care, prudent, and not in excess of actual costs incurred. Our review showed that of the \$13.3 million in home office costs charged by SCA to its affiliated ASCs, \$7.2 million did not meet Medicare regulations or guidelines for reimbursement. These included:

- 0 Debt guarantee fees of \$4.3 million;
- 0 Management service fees of \$2.4 million charged in excess of costs; and
- 0 General & Administrative expenses of \$.5 million for: abandoned development plans (\$.29 million); information systems expenses (\$.15 million); charitable contributions (\$.05 million); and wages not paid (\$.01 million).

Page 2 - Bruce C. Vladeck

The SCA also billed direct costs totaling approximately \$.2 million directly to the five member ASCs selected by HCFA for audit by the FIs. Our review of these costs showed that they were reimbursable in accordance with Medicare regulations and guidelines.

In response to our review, SCA officials stated that while they did not question the validity of the criteria we used in our review, they did not believe that this criteria was fair. The SCA officials believe that all incurred home office costs should be considered in setting ASC reimbursement rates.

The information in this report is being provided to HCFA officials for use in developing new ASC facility payment rates. No other recommendations are being made at this time. If you have any questions, please call me or have your staff contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits, at (410) 966-7104. Copies of this report are being sent to other interested Department officials.

To facilitate identification, please refer to Common Identification Number A-04-94-02091 in all correspondence relating to this report.

Attachments

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
HOME OFFICE COSTS OF
SURGICAL CARE AFFILIATES, INC.**



**JUNE GIBBS BROWN
Inspector General**

**JUNE 1995
A-04-94-02091**



Memorandum

JUN 13 1995

Date
From *for* *Michael Mangano*
June Gibbs Brown
Inspector General

Subject Review of Home Office Costs of Surgical Care Affiliates, Inc.
(A-04-94-02091)

TO
Bruce C. Vladeck
Administrator
Health Care Financing Administration

This report provides you with the results of our review of home office costs allocated by Surgical Care Affiliates, Inc. (SCA), of Nashville, Tennessee, to its individual ambulatory surgical centers (ASC). The Health Care Financing Administration (HCFA) requested that the Office of Inspector General (OIG) audit the home office costs allocated by two major ASC chains to the individual ASCs owned by these chains and included in a sample of 100 ASCs responding to a HCFA survey.

The HCFA survey focused on overhead and certain surgical procedure costs and other items related to services rendered at ASCs participating in the Medicare program. The HCFA asked the Medicare fiscal intermediaries (FI) to audit the survey responses provided by the individual ASCs. The purpose of our review was to validate the reported home office costs that would be used by HCFA in developing new ASC facility payment rates and to determine if these costs were reimbursable under Medicare regulations and guidelines. Of the 100 ASCs included in HCFA's sample, 5 were part of the SCA chain.

Generally, Medicare regulations and guidelines require that reimbursable costs be reasonable, related to patient care, prudent, and not in excess of actual costs incurred. Our review showed that of the \$13.3 million in home office costs charged by SCA to its affiliated ASCs, \$7.2 million did not meet Medicare regulations or guidelines for reimbursement. These included:

- o Debt guarantee fees of \$4.3 million;
- o Management service fees of \$2.4 million charged in excess of costs; and

- o General & Administrative expenses of \$.5 million for: abandoned development plans (\$.29 million); information systems expenses (\$.15 million); charitable contributions (\$.05 million); and **wages** not paid (\$.01 million).

The SCA also billed direct costs totaling approximately \$.2 million directly to the five member ASCs selected by HCFA for audit by the FIs. Our review of these costs showed that they were reimbursable in accordance with Medicare regulations and guidelines.

In response to our review, SCA officials stated that while they did not question the validity of the criteria we used in our review, they did not believe that this criteria was fair. The SCA officials believe that all incurred home office costs should be considered in setting ASC reimbursement rates.

INTRODUCTION

Background

As one of the conditions for participation in the Medicare program, ASCs agree to furnish HCFA information necessary to establish prospective payment rates for facility services provided to patients. During Calendar Years (CY) 1992 and 1994, ASCs provided requested information in the form of surveys--the Medicare Ambulatory Surgical Center Payment Rate Survey, HCFA-452 A & B. The HCFA last requested such information in 1986.

Part I of the survey, HCFA-452A, was designed to collect, from all ASCs currently participating in the Medicare program, basic descriptive information as well as certain utilization and charge data. For most ASCs, this survey applied to CY 1992 and was submitted to HCFA by September 11, 1992. A sample of ASCs responded to Part II of the survey, HCFA-452B, which focused on overhead costs and certain surgical procedure costs and other items related to services rendered at ASCs participating in the Medicare program. This survey applied to CY 1993 and was submitted to HCFA by May 31, 1994.

The HCFA engaged 35 FIs to audit the survey responses provided by a sample of 100 ASCs. The HCFA further requested the OIG to audit the home office costs allocated to 22 of these ASCs by Medical Care America, Inc. in Dallas, Texas and SCA in Nashville, Tennessee.

The SCA incorporated under the laws of Tennessee in 1982 and under the laws of Delaware in 1986. The SCA develops, owns, and operates ASCs. At December 31, 1993, the end of our audit period, SCA owned and operated 56 ASCs. At the time we conducted our review, SCA owned and operated 65 ASCs nationwide.

The SCA has about 2,000 full-time and part-time employees of which 25 are at corporate headquarters in Nashville, Tennessee. The SCA derives its revenues from the sale of ASC medical services. For CY 1993, the SCA received about \$198 million in revenues. The following table shows SCA's estimate of the percentage of income derived from contracted payers:

Medicare	30 percent
Commercial Insurance - Other than Blue Cross	24 percent
HMO or Preferred Providers	17 percent
Blue Cross	12 percent
Medicaid/Champus	10 percent
Self Pay	7 percent

The SCA's organization enters into partnership agreements with other individuals to operate ASCs. The SCA typically retains a majority ownership interest in the ASC and also controls the management of the ASCs. The individual ASCs operate independently of each other.

The SCA provides each ASC with development and operating services. These include: working capital and loans; various kinds of data processing services; architecture/site development; analysis of patient and staff flows; marketing services; purchasing; regulatory/certificate of need support; and corporate supervision and problem solution. In return for these services, the ASCs pay SCA an initial development fee and on-going payments consisting of management fees and direct expenses.

Scope

The objectives of our review were to validate the survey data submitted to HCFA by SCA and to determine whether home office costs were reimbursable under Medicare regulations and guidelines. To accomplish our objectives, we reviewed

the home office costs in total, and the direct costs charged by SCA to the five ASCs that were the subject of audits by the FIs. These ASCs were:

- o Forest Surgery Center - San Jose, California
- o Charlotte Surgery and Laser Center - Charlotte, North Carolina
- o Oshkosh Surgery Center - Oshkosh, Wisconsin
- o Roseland Surgical Center - Roseland, New Jersey
- o Chattanooga Surgery Center - Chattanooga, Tennessee

Our audit was performed in accordance with generally accepted government auditing standards. The objectives of our review did not call for an assessment of SCA's internal controls. We conducted our review at the home office of SCA in Nashville, Tennessee during the period November 1994 through December 1994.

RESULTS OF REVIEW

Our review showed that of the \$13.3 million in home office costs charged by SCA to its affiliated ASCs, \$4.8 million were not reimbursable in accordance with the Code of Federal Regulations (CFR) and HCFA's Provider Reimbursement Manual (PRM). In addition, we found that SCA charged the ASCs \$2.4 million for management services in excess of the costs actually incurred. The difference between cost and charges is not reimbursable under Medicare guidelines.

Our review of the approximately \$.2 million of direct costs for the five ASCs showed that all direct charges/costs were valid and reimbursable.

Nonreimbursable Costs

Debt Guarantee Fees Home office costs included debt guarantee fees totaling \$4,305,558. These fees generally represented 5 percent of the average loan amount charged to an ASC by SCA which acted as a surety for the loan. The fees were not reimbursable under Medicare regulations (42 CFR 413.17) because SCA did not incur any cost in rendering the surety service in CY 1993.

General and Administrative Expenses General and Administrative expenses totaling \$511,095 were not reimbursable under Medicare guidelines. These included:

- o unsuccessful development expenses of \$288,141. The Medicare guidelines state that if a home office abandons plans (to construct...or to purchase an

existing facility)... the costs of the abandoned plans are considered an investment loss and are not allowable (PRM -1,2150.2 E. 2. b.);

- o information system expense of \$156,344. This cost was charged directly to and reported by the individual ASCs and therefore should not be included as part of home office costs (PRM -1,2150.2 A.);
- o charitable contributions of \$55,311. These costs are not allowable as they represent costs not appropriate or necessary in developing and maintaining the operation of patient care facilities and activities (PRM -1,2102.3); and,
- o wages not paid of \$11,299. The SCA accrued \$315,000 for bonuses to be paid in CY 1994, however, the actual amount paid was \$303,701. The difference is not reimbursable (PRM -1,2150.2 A.).

Charges in Excess of Cost

The SCA charged its 56 ASCs a total of \$13.3 million for management services rendered in CY 1993. However, SCA only incurred \$10.9 million in providing these services to the ASCs. Medicare regulations do not allow the difference between charges and cost (\$2.4 million).

Appendix A shows the home office costs charged, the costs reimbursable, and the differences related to the five ASC's being reviewed by Fls.

CONCLUSION AND RECOMMENDATIONS

The information in this report is being provided to HCFA officials for use in developing new ASC facility payment rates. No other recommendations are being made at this time.

OTHER MATTERS

Interest Expense

Interest expense of approximately \$1 million reported by SCA consisted of interest incurred for four lines of credit (LOC) established with local banks. The SCA "draws" on these LOCs as they deem necessary. They do not record the purpose/use of the proceeds from the "draw." In addition, SCA did not distinguish between a draw for loans to individual ASCs and draws to purchase stock or to acquire existing ASCs. Interest paid between related parties is unallowable. The documentation was not adequate to determine the amount, if any, related to outstanding loan amounts with the ASCs.

Home Office Costs Reported on HCFA Survey

When responding to HCFA's request for cost information, SCA reported only \$9.2 million of home office costs. The SCA representatives indicated they had made an error in completing the cost documents and the actual amount should have been \$10.9 million. We used the revised amount in our review.

SCA COMMENTS

We provided SCA officials with a draft report and telephonically discussed our results with them on February 7, 1995. They declined the opportunity to provide written comments to the draft. The SCA officials stated that they felt all home office costs should be included in calculating the new rates for ASC services. Otherwise they accepted and agreed with the results of our review.

APPENDIX A

SCA HOME OFFICE
COSTS FROM SURVEY AND COSTS REIMBURSABLE
FOR FIVE ASCs REVIEWED
CALENDAR YEAR 1993

<u>ASC</u>	<u>HOME OFFICE</u> <u>COSTS FROM SURVEY</u> <u>PER ASC</u>	<u>COSTS</u> <u>REIMBURSABLE</u>	<u>DIFFERENCE</u>
Forest	\$ 195,451	\$ 128,866	\$ 66,585
Charlotte	255,213	168,270	86,943
Oshkosh	113,036	74,528	38,508
Roseland	273,255	180,165	93,090
Chattanooga	<u>227,039</u>	<u>149,693</u>	<u>77,346</u>
FIVE ASCs	\$ 1,063,994	\$ 701,522	\$ 362,472
OTHER ASCs	<u>9,803,495</u>	<u>5,349,314</u>	<u>4,454,181</u>
TOTAL ASCS	\$10,867,489	\$6,050,836	\$4,816,653
PROFIT CHARGED BY HOME OFFICE	<u>2,393,016</u>	<u>0</u>	<u>2,393,016</u>
TOTAL	<u>\$13,260,505</u>	<u>\$6,050,836</u>	<u>\$7,209,669</u>

NOTE

We determined the costs reimbursable for the individual ASCs by applying the same allocation methodology utilized by SCA in reporting management fee costs to the amounts determined reimbursable (in total) in our review. We then subtracted that amount from the respective amount provided to HCFA to determine the difference or nonreimbursable amount.